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**Thames Water Aqua US Holdings, Inc.
and Subsidiary Companies**

(a wholly owned subsidiary of RWE Aktiengesellschaft)

Consolidated Financial Statements

As of and for the Years Ended December 31, 2005 and 2004

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PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

To the Board of Directors and Shareholder of
Thames Water Aqua US Holdings, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows, changes in common stockholder's equity and comprehensive income present fairly, in all material respects, the financial position of Thames Water Aqua US Holdings, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

January 11, 2007

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Consolidated Balance Sheets
December 31, 2005 and 2004
(Dollars in thousands)

ASSETS		
	2005	2004
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	\$ 8,105,793	\$ 7,772,223
Nonutility property, net of accumulated depreciation	114,439	112,888
Total property, plant and equipment	<u>8,220,232</u>	<u>7,884,911</u>
Current assets		
Cash and cash equivalents	65,077	78,856
Restricted funds	7,497	37,880
Utility customer accounts receivable	138,600	145,345
Allowance for uncollectible accounts	(15,051)	(9,748)
Unbilled utility revenues	105,998	185,151
Other receivables, net	130,177	142,198
Materials and supplies	27,482	34,321
Assets of discontinued operations	2,758	50,107
Other	43,584	44,985
Total current assets	<u>504,080</u>	<u>709,095</u>
Regulatory and other long-term assets		
Regulatory assets	529,754	535,953
Other investments	3,861	6,833
Restricted funds	2,431	-
Goodwill	3,153,702	3,550,050
Other	85,949	86,843
Total regulatory and other long-term assets	<u>3,775,697</u>	<u>4,179,679</u>
TOTAL ASSETS	<u>\$ 12,500,009</u>	<u>\$ 12,773,685</u>

The accompanying notes are an integral part of these consolidated financial statements.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Consolidated Balance Sheets
December 31, 2005 and 2004
(Dollars in thousands)

CAPITALIZATION AND LIABILITIES

	<u>2005</u>	<u>2004</u>
Capitalization		
Common stockholder's equity	\$ 2,789,521	\$ 3,101,863
Preferred stock without mandatory redemption requirements	4,571	4,851
Long-term debt		
Long-term debt	3,011,827	4,195,581
Redeemable preferred stock at redemption value	1,774,891	1,775,224
Total capitalization	<u>7,560,610</u>	<u>9,077,119</u>
Current liabilities		
Short-term debt	374,063	859,397
Current portion of long-term debt	1,643,655	48,360
Current portion of redeemable preferred stock at redemption value	533	553
Accounts payable	135,727	198,283
Taxes accrued, including federal income	65,408	88,583
Interest accrued	52,908	48,342
Liabilities of discontinued operations	-	20,558
Other	193,847	184,708
Total current liabilities	<u>2,466,137</u>	<u>1,404,782</u>
Regulatory and other long-term liabilities		
Advances for construction	580,659	500,150
Deferred income taxes	581,658	522,922
Deferred investment tax credits	37,935	39,261
Regulatory liability-cost of removal	152,666	138,418
Accrued pension expense	257,328	242,376
Accrued postretirement benefit expense	141,128	146,998
Other	66,886	47,258
Total regulatory and other long-term liabilities	<u>1,778,278</u>	<u>1,637,383</u>
Contributions in aid of construction	<u>694,984</u>	<u>654,421</u>
Commitments and contingencies	-	-
TOTAL CAPITALIZATION AND LIABILITIES	<u>\$ 12,500,009</u>	<u>\$ 12,773,685</u>

The accompanying notes are an integral part of these consolidated financial statements.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Consolidated Statements of Operations
For the Years Ended December 31, 2005 and 2004
(Dollars in thousands)

	<u>2005</u>	<u>2004</u>
Operating revenues	<u>\$ 2,203,705</u>	<u>\$ 2,090,642</u>
Operating expenses		
Operation and maintenance	1,289,947	1,191,287
Depreciation and amortization	261,364	225,260
General taxes	183,324	170,165
Gain on sales of assets	(8,517)	(8,611)
Impairment charges	420,370	165,082
Total operating expenses, net	<u>2,128,488</u>	<u>1,743,183</u>
Operating income	<u>75,217</u>	<u>347,459</u>
Other income (deductions)		
Interest	(345,278)	(316,011)
Allowance for other funds used during construction	5,810	5,476
Allowance for borrowed funds used during construction	2,420	2,923
Amortization of debt expense	(4,367)	(3,377)
Preferred dividends of subsidiaries	(227)	(410)
Other, net	6,448	5,791
Total other income (deductions)	<u>(335,194)</u>	<u>(305,608)</u>
Income (loss) from continuing operations before income taxes	(259,977)	41,851
Provision for income taxes	55,671	84,157
Loss from continuing operations	<u>(315,648)</u>	<u>(42,308)</u>
Loss from discontinued operations, net of tax	<u>(16,895)</u>	<u>(45,989)</u>
Net loss	<u>\$ (332,343)</u>	<u>\$ (88,295)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2005 and 2004
(Dollars in thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	\$ (332,343)	\$ (88,295)
Adjustments		
Loss on sale of discontinued operations	16,350	-
Depreciation and amortization	281,384	225,260
Impairment charges	420,370	215,951
Removal costs net of salvage	32,198	32,164
Provision for deferred income taxes	39,228	107,202
Amortization of deferred investment tax credits	(1,326)	(1,805)
Provision for losses on utility accounts receivable	20,962	21,973
Allowance for other funds used during construction	(5,810)	(5,476)
Employee benefit expenses greater (less) than funding	4,251	(9,075)
Gain on sale of assets	(8,517)	(8,611)
Deferred regulatory costs	(10,427)	(15,088)
Amortization of deferred charges	24,993	16,877
Other, net	9,623	8,311
Changes in assets and liabilities		
Accounts receivable	12,729	(10,547)
Unbilled utility revenues	79,155	(4,575)
Taxes receivable, including federal income	-	18,822
Other current assets	26,583	(47,848)
Accounts payable	(64,195)	28,753
Taxes accrued, including federal income	(1,157)	18,812
Interest accrued	4,584	(6,682)
Other current liabilities	(5,158)	(37,737)
Net cash from operating activities	<u>525,435</u>	<u>458,408</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction expenditures	(558,446)	(548,241)
Allowance for other funds used during construction	5,810	5,476
Acquisitions	(4,979)	(35,855)
Proceeds from sale of assets and securities	1,528	6,726
Proceeds from sale of discontinued operations	15,336	17,000
Removal costs from property, plant and equipment retirements	(17,928)	(12,870)
Receivable from affiliates	562	54,351
Restricted funds	27,952	(34,490)
Net cash used in investing activities	<u>(530,155)</u>	<u>(545,903)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	494,322	412,242
Net repayments under short-term debt agreements	(485,334)	(128,408)
Advances and contributions for construction, net of refunds	51,985	45,061
Debt issuance costs	(3,347)	(4,288)
Repayment of long-term debt	(66,039)	(215,761)
Redemption of preferred stocks	(636)	(13,592)
Net cash from (used in) financing activities	<u>(9,049)</u>	<u>95,254</u>
Net increase in cash and cash equivalents	(13,779)	7,759
Cash and cash equivalents at January 1	78,856	71,097
Cash and cash equivalents at December 31	<u>\$ 65,077</u>	<u>\$ 78,856</u>
Cash paid during the year for:		
Interest, net of capitalized amount	<u>\$ 245,834</u>	<u>\$ 233,809</u>
Income taxes paid (net of refunds)	<u>\$ 43,694</u>	<u>\$ 18,109</u>

The accompanying notes are an integral part of these consolidated financial statements.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Consolidated Statements of Changes in Stockholder's Equity and Comprehensive Income (Loss)
December 31, 2005 and 2004
(Dollars in thousands)

	Common Stock Shares	Par Value	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Common Stockholder's Equity	Comprehensive Income (Loss)
Balance at December 31, 2003	1,000	\$ -	\$ 3,378,000	\$ (188,606)	\$ 4,234	\$ 3,193,628	
Net loss	-	-	-	-	-	(88,295)	\$ (88,295)
Market value adjustments for investments, net of tax	-	-	-	-	-	(2,565)	(2,565)
Additional minimum pension liability, net	-	-	-	-	-	267	267
Foreign currency translation	-	-	-	-	-	(1,373)	(1,373)
Total comprehensive loss	-	-	-	-	-	(8,393)	\$ (8,393)
Balance at December 31, 2004	1,000	\$ -	\$ 3,378,000	\$ (276,901)	\$ 563	\$ 3,101,663	
Net loss	-	-	-	-	-	(332,343)	\$ (332,343)
Market value adjustments for investments, net of tax	-	-	-	-	-	(233)	(233)
Additional minimum pension liability, net	-	-	-	-	-	(472)	(472)
Foreign currency translation	-	-	-	-	-	906	906
Total comprehensive loss	-	-	-	-	-	(764)	\$ (764)
Balance at December 31, 2005	1,000	\$ -	\$ 3,378,000	\$ (609,244)	\$ 764	\$ 2,769,521	

The accompanying notes are an integral part of these consolidated financial statements.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Notes to Consolidated Financial Statements
December 31, 2005 and 2004

(Dollars in thousands, except per share amounts)

Note 1: Organization and Operation

Thames Water Aqua US Holdings, Inc. ("TWAUSHI"), a wholly owned subsidiary of RWE Aktiengesellschaft ("RWE") is the holding company for regulated and unregulated subsidiaries providing water and wastewater service in the United States of America and Canada. As public utilities, the regulated subsidiaries function under rules and regulations prescribed by state regulators. The regulated business includes the regulated utilities, each of which has similar economic characteristics and are operationally segregated by state. The unregulated business includes eight distinctive lines of business including operations and maintenance, residuals, underground, carbon, engineering, homeowner services, military and leasing. TWAUSHI and its subsidiaries as a consolidated entity are referred to herein as the Company.

Note 2: Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the parent company and its subsidiaries. Intercompany balances and transactions between subsidiaries have been eliminated. The Company uses the equity method to report its investments in two affiliated companies in each of which the Company holds a 50% voting interest and cannot exercise control over the operations and policies of the investments. Under the equity method, the Company records its interests as an investment and its percentage share of earnings as earnings or losses of investee. The Company has analyzed its variable interests in the investments in accordance with the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" and determined the Company is not the primary beneficiary.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Regulation

The regulated utility subsidiaries are subject to regulation by the public utility commissions and the local governments of the states in which they operate ("Regulators"). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). This statement sets forth the application of generally accepted accounting principles for those companies whose rates are established by or are subject to approval by an independent third-party regulator. Under SFAS 71, regulated utility companies defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in income by an unregulated company. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in the rates charged for service.

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. The costs incurred to acquire and internally develop computer software for internal use are capitalized as a unit of property. Repairs and maintenance are charged to current operations.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Notes to Consolidated Financial Statements
December 31, 2005 and 2004

(Dollars in thousands, except per share amounts)

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method.

Non-utility property consists primarily of buildings and equipment utilized by the Company for internal operations. This property is stated at cost, net of accumulated depreciation calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to 40 years.

Cash and Cash Equivalents

Substantially all cash is invested in interest bearing accounts. All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

Restricted Funds

Restricted funds represent proceeds received from financings for the construction and capital improvement of utility facilities. The proceeds of these financings are held in escrow until the capital expenditures are incurred. Restricted funds expected to be released within 12 months subsequent to year-end are classified as current.

Utility Customer Accounts Receivable

Regulated utility customer accounts receivable represent amounts billed to water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators and generally, collateral is not required.

Allowance for Uncollectible Accounts

Allowances for uncollectible accounts are maintained for estimated probable losses resulting from the inability of customers to make required payments. The Company continues to assess the adequacy of the reserves for doubtful accounts based on the financial condition of the Company's customers and other external factors that may impact collectibility. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes off accounts when they become uncollectible.

Other Receivables, Net

Other receivables, net primarily consists of unregulated trade accounts receivable, net of a reserve for doubtful accounts and unbilled receivables. The reserve from continuing operations amounted to \$9,336 and \$8,334 at December 31, 2005 and 2004. In determining the reserve for uncollectible unregulated accounts, the Company considers the length of time the trade accounts receivable are past due and the customer's current ability to pay their obligation. Unbilled receivables are accrued when service has been provided but has not been billed to customers.

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Notes to Consolidated Financial Statements
December 31, 2005 and 2004
(Dollars in thousands, except per share amounts)

Goodwill

The Company considers this to be one of the critical accounting estimates used in the preparation of the consolidated financial statements. The Company believes the current assumptions and other considerations used to value goodwill to be appropriate. However, if actual experience differs from the assumptions and considerations used in its analysis, the resulting change could have a material impact on the consolidated financial statements.

Goodwill is associated with the acquisitions of American Water Works Company, Inc. in 2003 and E'town Corporation in 2001 (the "Acquisitions") and has been assigned to reporting units based on the fair values at the date of the Acquisitions. The regulated utility subsidiaries have been aggregated and deemed a single reporting unit as they have similar economic characteristics. In the unregulated segment, the business is organized into eight reporting units for its unregulated services. In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill is reviewed annually, or more frequently if changes in circumstances indicate the carrying value may not be recoverable. To test for impairment, the Company utilizes discounted estimated future cash flows (and comparable public company analyses for the regulated segment) to measure fair value for each reporting unit. This calculation is highly sensitive to both the estimated future cash flows of each reporting unit and the discount rate assumed in these calculations. Annual impairment reviews are done in the fourth quarter of the calendar year, in conjunction with the timing of the Company's annual strategic business plan.

For the years ended December 31, 2005 and 2004, the Company determined that its goodwill was impaired and recorded impairments of \$396,348 and \$192,936, respectively. (See Note 16)

Impairment of Long-Lived Assets

The Company believes this to be one of the critical accounting estimates used in the preparation of its consolidated financial statements. The Company believes the current assumptions and other considerations used to evaluate the carrying value of long-lived assets to be appropriate. However, if actual experience differs from the assumptions and considerations used in its estimates, the resulting change could have a material adverse impact on the Consolidated Statements of Operations and Balance Sheets.

Long-lived assets, other than goodwill which is discussed above, include land, buildings, equipment and long-term investments. Long-lived assets, other than investments, land and goodwill, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market price of a long-lived asset, a significant adverse change in the manner the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, the Company estimates the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets and compares that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recorded.

The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the assets carrying value exceeds its fair value.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Notes to Consolidated Financial Statements
December 31, 2005 and 2004
(Dollars in thousands, except per share amounts)

Due to changes in the Company's strategic business plan, the Company performed a valuation of long-lived assets, other than investments and goodwill, as of December 31, 2005 and 2004. As a result of the impairment analyses, the Company recorded pretax charges of \$24,022 and \$23,015 for the years ended December 2005 and 2004, respectively. The impairments primarily resulted from lower than expected growth, slower development compared with original expectations, and a building with a carrying value that exceeded its fair value. These charges are included in impairment charges in the statements of operations. The remaining values as of December 31, 2005 and 2004 were determined to be appropriate.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which the Company invests, as well as volatility inherent in the external markets. In assessing potential impairment for these investments, the Company considers these factors and in one case also receives annual appraisals. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value. The Company determined the values of long-term investments were appropriate for the years ended December 31, 2005 and 2004.

Other Investments

Other investments include investments in public equity securities classified as available for sale, privately held companies, and investments in affiliated companies accounted for using the equity method.

Advances and Contributions in Aid of Construction

Regulated utility subsidiaries may receive advances and contributions to fund construction necessary to extend service to new areas. As determined by the Regulators, advances for construction are refundable for limited periods of time as new customers begin to receive service. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from rate base and is generally not depreciated for rate making purposes. Non-cash utility property has been received, primarily from developers, as advances or contributions of \$85,818 and \$101,704 for the years ended December 31, 2005 and 2004, respectively.

Recognition of Revenues

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are provided and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period. Revenue from unregulated operations is recognized as services are provided.

Revenues from certain construction projects are recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes known. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities on the balance sheet until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Notes to Consolidated Financial Statements
December 31, 2005 and 2004

(Dollars in thousands, except per share amounts)

Construction Contract

In accordance with the American Institute of Certified Public Accountants' Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production Type Contracts," the Consolidated Statements of Operations include revenues and operation and maintenance expenses related to an agreement for the design, construction and operation of a water treatment plant. Under this agreement, revenues were \$75,013 and \$60,706 and operation and maintenance expenses were \$74,874 and \$60,706 as of December 31, 2005 and 2004, respectively.

The construction is scheduled to be completed in 2007, and the Company will operate and maintain the water treatment plant for an initial contract period of twenty years beginning in 2007.

Income Taxes

The parent company and its subsidiaries and affiliates participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. Deferred income taxes have been provided on the difference between the tax bases of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates to be in effect when such temporary differences are expected to reverse. The regulated utility subsidiaries also recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse.

Investment tax credits have been deferred by the regulated utility subsidiaries and are being amortized to income over the average estimated service lives of the related assets.

Allowance for Funds Used During Construction ("AFUDC")

AFUDC is a non-cash credit to income with a corresponding charge to utility plant which represents the cost of borrowed funds and a return on equity funds devoted to plant under construction. The regulated utility subsidiaries record AFUDC to the extent permitted by the Regulators.

Environmental Costs

Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$5,557 and \$0 at December 31, 2005 and 2004, respectively. (See Note 4)

New Accounting Standards

In September 2006, the FASB issued FAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106 and 132(R)." This statement requires the recognition of the over funded or under funded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS No. 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized in net periodic benefit cost under previous accounting standards will be recognized in accumulated other comprehensive income, net of tax effects. The Company intends to adopt SFAS No. 158 on December 31, 2006 as required. The Company is currently unable to estimate the impact of adopting SFAS No. 158 on its Consolidated Balance Sheet since the impact is dependent on plan asset performance through the end of 2006, interest rates and other factors. The Company is currently evaluating whether it will establish a regulatory asset for the pension and other postretirement costs associated with SFAS No. 158 for which the Company anticipates recoverability through customer rates that would otherwise be charged to common stockholders' equity. Based on the Company's unfunded obligation as of December 31, 2005, and had the Company adopted SFAS No. 158 as of that date, the Company's liabilities would have increased by approximately \$158,280.

Thames Water Aqua US Holdings, Inc. and Subsidiary Companies
Notes to Consolidated Financial Statements
December 31, 2005 and 2004
(Dollars in thousands, except per share amounts)

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies when other statements require or permit the fair value measurement of assets and liabilities. This statement does not expand the use of fair value measurement. SFAS No. 157 is effective for the Company beginning January 1, 2008. The Company is currently evaluating the provisions of this statement and has not yet determined the effect of adoption on its results of operations or financial position.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 is effective for the fiscal year ended December 31, 2008. The Company believes SAB 108 will have no impact on its results of operations or financial position.

On July 14, 2006, the FASB issued Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes," an interpretation of SFAS No. 109, "Accounting for Income Taxes." FIN 48 is intended to address inconsistencies among entities with the measurement and recognition in accounting for income tax deductions for financial statement purposes. Specifically, FIN 48 addresses the timing of the recognition of income tax benefits. FIN 48 requires the financial statement recognition of an income tax benefit when the Company determines that it is more-likely-than-not that the tax position will be sustained. FIN 48 is effective for fiscal years beginning after December 15, 2006. Upon adoption of FIN 48, the cumulative effect shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Company will adopt FIN 48 effective January 1, 2007. The Company is currently assessing the impact FIN 48 will have on its results of operations, financial position, and cash flows.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," which clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. The adoption had no impact on the financial position, results of operations or cash flows of the Company.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees." SFAS 123R generally requires that the Company measure the cost of employee services received in exchange for stock-based awards on the grant-date fair value and this cost will be recognized over the period during which an employee provides service in exchange for the award. The adoption had no impact on the financial position, results of operations or cash flows of the Company.

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. Among other provisions, the AJCA creates a new deduction for qualified domestic production activities. Certain activities of the Company, such as its water treatment activity, are considered as qualifying production activities for purposes of determining the deduction for qualified production activities. In December 2004, the FASB issued FASB Staff Position 109-1 ("FSP 109-1"), "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." In accordance with FSP 109-1, the Company will treat the deduction for qualified domestic production activities as a reduction of the income tax provision in the period as realized. Since the deduction cannot increase a net operating loss, and all members of an affiliated group are treated as a single tax payer, the Company is not eligible for the credit in 2005.

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Note 3: Utility Plant

The components of utility plant by category at December 31 are as follows:

	Range of Remaining Useful Lives	2005	2004
Water plant			
Land and other non-depreciable assets		\$ 134,818	\$ 131,238
Sources of supply	15 to 83 Years	422,318	406,428
Treatment and pumping facilities	2 to 74 Years	2,072,205	2,028,125
Transmission and distribution facilities	8 to 98 Years	4,714,806	4,423,839
Services, meters and fire hydrants	1 to 98 Years	1,709,413	1,805,273
General structures and equipment	3 to 88 Years	740,037	706,815
Wastewater plant	4 to 75 Years	438,570	401,187
Construction work in progress		254,734	265,114
		10,484,899	9,865,815
Less accumulated depreciation		2,379,106	2,193,582
		<u>\$ 8,105,793</u>	<u>\$ 7,772,233</u>

Utility plant depreciation expense amounted to \$241,633 in 2005 and \$204,325 in 2004. Included in the 2005 amount is \$21,644 resulting from an information technology project that was abandoned.

Note 4: Regulatory Assets

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Except for income taxes, regulatory assets are excluded from the Company's rate base and do not earn a return. The components of regulatory assets are as follows:

	2005	2004
Regulatory asset-income taxes recoverable through rates	\$ 223,366	\$ 226,631
Debt and preferred stock expense	66,070	67,505
Deferred pension expense	68,554	61,352
Deferred postretirement benefit expense	8,182	9,223
Deferred security costs	25,239	29,552
Deferred business services project expenses	23,960	31,273
Deferred tank painting costs	12,943	12,613
Deferred rate case	8,790	10,442
Purchase premium recoverable through rates	61,314	61,844
Environmental remediation recoverable through rates	5,557	-
Other	25,779	25,718
	<u>\$ 529,754</u>	<u>\$ 535,953</u>

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the regulatory authorities of full normalization for rate making purposes. Full normalization requires no flow through of tax benefits to customers. The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

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Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from date of issue; expenses of issues with sinking fund provisions are charged to operations as shares are retired.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain subsidiaries. These costs will be recovered in future service rates as contributions are made to the pension plan.

Postretirement benefit expense in excess of the amount recovered in rates through 1997 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service and will be fully recovered over a 20-year period ending in 2012 as authorized by the regulatory authorities.

The cost of additional security measures that were implemented to protect facilities after the terrorist attacks on September 11, 2001 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service by certain subsidiaries.

Business services project expenses consist of reengineering and start-up activities for consolidated customer and shared administrative service centers that began operations in 2001. These costs are recognized in the rates charged for water service by certain subsidiaries.

Tank painting costs are generally deferred and amortized to current operations on a straight-line basis over periods ranging from 5 to 15 years, as authorized by the regulatory authorities in their determination of rates charged for service.

Purchase premium recoverable through rates is the recovery of the acquisition premium related to an asset acquisition by the Company's California subsidiary during 2002. As authorized for recovery by the California regulator, these costs are being amortized to operations based on an agreed schedule of mortgage style amortization. The recovery period is from May 2004 through December 2041.

Environmental remediation recoverable through rates is a recovery of costs incurred by the Company's California subsidiary under a settlement agreement entered into with the National Oceanic and Atmospheric Administration to improve habitat conditions in the Carmel River Watershed.

Note 5: Employee Benefits

Pension and Other Postretirement Benefits

The Company maintains noncontributory defined benefit pension plans covering substantially all non-union employees of its regulated utility and shared services operations. Benefits under the plans are based on the employee's years of service and compensation. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 have their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 will be provided with a 5.25% of base pay defined contribution plan.

The Company's funding policy is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974. Pension plan assets are invested in a number of investments including equity and bond mutual funds, fixed income securities and guaranteed interest contracts with Principal and Hancock insurance companies.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain regulated subsidiaries pending future recovery in rates charged for utility services as contributions are made to the plans. (see Note 4)

The Company also has several unfunded noncontributory supplemental non-qualified pension plans that provide additional retirement benefits to certain employees.

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The Company maintains postretirement benefit plans providing varying levels of medical and life insurance to eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002.

The Company's policy is to fund postretirement benefit costs accrued. Plan assets are invested in equity and bond mutual funds.

The obligations of the plans are dominated by obligations for active employees. Because the timing of expected benefit payments is so far in the future and the size of the plan assets are small relative to the Company's assets, the investment strategy is to allocate a large portion of assets to equities, which the Company believes will provide the highest return over the long run. The fixed income assets are invested in long duration debt securities in order to better match the duration of the plan liability.

The liabilities of the pension and other postretirement benefit plans were adjusted to their fair value at the time of the Acquisitions. The Company periodically conducts an asset liability modeling study to ensure the investment strategy is aligned with the profile of the obligations. The long-term goals are to maximize the plan funded status and minimize contributions and pension expense, while taking into account the potential volatility risks on each of these items.

The asset allocation for the Company's U.S. pension plans at the end of 2005 and 2004 by asset category, follows:

Asset category	Target Allocation 2005	Percentage of Plan Assets At Year End	
		2005	2004
Equity securities	60%	59%	52%
Debt securities	40%	41%	47%
Cash	0%	0%	1%
Total	100%	100%	100%

The Company's other postretirement benefit plans are partially funded. The asset allocation for the Company's other postretirement benefit plans at the end of 2005 and 2004, by asset category, follows:

Asset category	Target Allocation 2005	Percentage of Plan Assets At Year End	
		2005	2004
Equity securities	60%	64%	64%
Debt securities	40%	36%	36%
Total	100%	100%	100%

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	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Change in benefit obligation				
Benefit obligation at January 1	\$ 779,250	\$ 713,884	\$ 420,210	\$ 397,120
Service cost	26,887	26,413	13,880	12,872
Interest cost	47,584	45,558	25,158	23,384
Plan participants' contributions	-	-	1,597	1,422
Amendments	(489)	1,872	(18,571)	446
Actuarial (gain) loss	48,799	13,015	3,918	2,652
Curtailments	(2,377)	-	-	-
Special termination benefits	890	2,171	-	-
Benefits paid	(28,732)	(23,443)	(18,117)	(17,488)
Benefit obligation at December 31	\$ 889,922	\$ 779,250	\$ 427,653	\$ 420,210
Change in Plan Assets				
Fair value of plan assets at January 1	\$ 480,153	\$ 444,415	\$ 216,452	\$ 188,848
Actual return on plan assets	23,508	38,800	13,868	17,188
Employer contribution	24,488	20,581	28,760	28,484
Plan participants' contributions	-	-	1,597	1,422
Benefits paid	(28,732)	(23,443)	(17,248)	(17,488)
Fair value of plan assets at December 31	\$ 499,416	\$ 480,153	\$ 243,249	\$ 216,452
Funded status at December 31	\$ (370,506)	\$ (299,097)	\$ (184,804)	\$ (203,758)
Unrecognized net transition obligation (asset)	-	-	1,577	2,902
Unrecognized prior service cost	2,260	3,584	(18,843)	1,420
Unrecognized net actuarial (gain) loss	112,544	53,989	58,742	52,438
Net amount recognized	\$ (255,702)	\$ (241,534)	\$ (141,128)	\$ (146,998)
Amounts recognized in the balance sheet consist of:				
Accrued benefit liability	\$ (255,702)	\$ (241,534)	\$ (141,128)	\$ (146,998)
Additional minimum liability	(2,858)	(3,650)	-	-
Intangible asset	1,230	2,808	-	-
Accumulated other comprehensive income	1,626	842	-	-
Net amount recognized	\$ (255,702)	\$ (241,534)	\$ (141,128)	\$ (146,998)

At December 31, 2005 and 2004, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with a projected obligation in excess of plan assets were as follows:

	Projected Benefit Obligation Exceeds the Fair Value of Plans' Assets	
	2005	2004
Projected benefit obligation	\$ 870,000	\$ 779,000
Fair value of plan assets	499,000	480,000
	Accumulated Benefit Obligation Exceeds the Fair Value of Plans' Assets	
	2005	2004
Accumulated benefit obligation	\$ 741,000	\$ 621,000
Fair value of plan assets	499,000	480,000

The accumulated postretirement benefit obligation exceeds plan assets for all of the Company's other postretirement benefit plans.

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Minimum funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. The Company plans to contribute at least amounts equal to the minimum required contributions in 2006 to the qualified pension plans. The Company plans to contribute its 2006 other postretirement benefit cost to its VEBA trusts.

Information about the expected cash flows for the pension and postretirement benefit plans is as follows:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2006 expected employer contributions		
To plan trusts	\$ 51,600	\$ 25,580
To plan participants	3,001	812

The following table reflects the net benefits expected to be paid from the plan assets or the Company's assets:

	<u>Pension Benefits</u>	<u>Other Benefits</u>	
	<u>Expected Benefit Payments</u>	<u>Expected Benefit Payments</u>	<u>Expected Federal Subsidy Payments</u>
2006	\$ 29,027	\$ 19,035	\$ 1,473
2007	28,221	21,027	1,647
2008	32,111	22,800	1,846
2009	33,806	24,908	2,013
2010	36,464	26,986	2,181
2011 - 2015	233,898	161,804	13,546

Because the above amounts are net benefits, plan participants' contributions have been excluded from the expected benefits.

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually with assistance from the Company's actuarial consultant who provides guidance in establishing the assumptions. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes.

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The significant assumptions related to the Company's pension and other postretirement benefit plans are as follows:

	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Weighted-average assumptions used to determine December 31 benefit obligations				
Discount rate	5.65%	6.00%	5.65%	6.00%
Rate of compensation increase	4.25%	4.75%	N/A	N/A
Medical trend	N/A	N/A	graded from 10% in 2005 to 5% in 2011+	graded from 10% in 2005 to 5% in 2010+
Weighted-average assumptions used to determine net periodic cost				
Discount rate	6.00%	6.25%	6.00%	6.25%
Expected return on plan assets	6.75%	6.75%	6.40%	6.40%
Rate of compensation increase	4.75%	4.75%	N/A	N/A
Medical trend	N/A	N/A	graded from 10% in 2005 to 5% in 2010+	graded from 10% in 2004 to 5% in 2009+

N/A - Assumption is not applicable.

The discount rate assumption was determined for the pension and postretirement benefit plans independently. A yield curve was developed for a universe containing the majority of U.S. - issued Aa - graded corporate bonds, all of which were non callable (or callable with make-whole provisions). For each plan, the discount rate was developed as the level equivalent rate that would produce the same present value as that using spot rates aligned with the projected benefit payments.

The expected long-term rate of return on plan assets is based on historical and projected rates of return for current and planned asset classes in the plans' investment portfolios. Assumed projected rates of return for each of the plans' projected asset classes were selected after analyzing historical experience and future expectations of the returns and volatility of the various asset classes. Based on the target asset allocation for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to the benchmark returns and for the effect of expenses paid from plan assets. The Company's pension expense increases as the expected return on assets decreases.

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care trend rate is based on historical rates and expected market conditions. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on total of service and interest cost components	\$ 5,838	\$ (4,864)
Effect on other postretirement benefit obligation	\$ 56,358	\$ (47,940)

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The following table provides the components of net periodic benefit costs for the years ended December 31:

	2005	2004
Components of net periodic pension benefit cost		
Service cost	\$ 28,987	\$ 26,413
Interest cost	47,594	45,558
Expected return on plan assets	(41,138)	(38,898)
Amortization of:		
Transition obligation/(asset)	-	(27)
Prior service cost	710	737
Actuarial (gain)/loss	384	436
Periodic pension benefit cost	\$ 34,539	\$ 34,219
Special termination pension benefit charge	890	2,171
Curtailment charge	135	-
Settlement charge/(credit)	240	9
Net periodic pension benefit cost	\$ 35,804	\$ 36,399
Components of net periodic other postretirement benefit cost		
Service cost	\$ 13,860	\$ 12,672
Interest cost	25,156	23,384
Expected return on plan assets	(18,857)	(16,320)
Amortization of:		
Transition obligation/(asset)	282	383
Prior service cost	81	74
Actuarial (gain)/loss	634	412
Periodic other postretirement benefit cost	\$ 21,156	\$ 20,585
Curtailment charge	655	-
Net periodic other postretirement benefit cost	\$ 21,811	\$ 20,585

The total additional minimum liability for the pension plans has decreased from \$3,650 at December 31, 2004 to \$2,856 at December 31, 2005.

Savings Plans for Employees

The Company maintains 401(k) savings plans that allow employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company expensed matching contributions to the plans totaling \$5,511 for 2005 and \$5,364 for 2004. All of the Company's matching contributions are invested in one or more funds at the direction of the employee.

Employees' Investment Plan

Upon completion of the American Water Works Company, Inc. acquisition, the Company created the Employees' Investment Plan and converted the Employees' Stock Ownership Plan into this plan. Each participating employee can elect to contribute an amount that does not exceed 2% of their wages. In addition to the employee's participation, the Company makes a contribution equivalent to 1/2% of each participant's qualified compensation, and matches 100% of the contribution by each participant. The Company made contributions to the plan totaling \$1,010 for 2005 and \$2,201 for 2004 that were primarily invested in a retirement trust fund. This plan was discontinued as of May 22, 2005.

Long-Term Incentive Plan

The Company participates in a RWE long-term incentive plan for executives ("RWE LTIP"). Under the RWE LTIP, Company employees were granted 120,004 performance shares of RWE common stock which vest over three years beginning January 1, 2005. Subject to the vesting provisions, the performance shares are payable in cash. As a result, the performance shares have been

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accounted for as a liability. The liability will be remeasured at fair value at each reporting period until settlement. The Company recorded a liability of \$1,400 related to the performance shares at December 31, 2005, which has been included in other current liabilities on the Consolidated Balance Sheets. For the year ended December 31, 2005, the Company recognized approximately \$1,400 of share-based compensation expense related to the performance shares in operations and maintenance expense.

The fair value of the performance shares was estimated using Monte Carlo simulations. The fair value of the performance shares granted on January 1, 2005 was \$21.73 per share at the grant date and \$35.53 per share at December 31, 2005.

The following table summarizes performance share transactions under the RWE LTIP plan:

	2005 tranche
Outstanding at the start of the fiscal year	-
Granted	120,004
Forfeited	-
Outstanding at the end of the fiscal year	120,004
Exercisable at the end of the fiscal year	-

Note 6: General Taxes

Components of general tax expense from continuing operations for the years presented in the Consolidated Statements of Operations are as follows:

	2005	2004
Gross receipts and franchise	\$ 69,237	\$ 63,106
Property and capital stock	77,535	75,219
Payroll	28,897	23,683
Other general	9,655	8,157
	<u>\$ 183,324</u>	<u>\$ 170,165</u>

Note 7: Income Taxes

Components of income tax expense from continuing operations for the years presented in the Consolidated Statements of Operations are as follows:

	2005	2004
State income taxes		
Current	\$ 8,456	\$ 18,706
Deferred		
Current	590	(149)
Non-current	4,327	2,194
	<u>\$ 13,373</u>	<u>\$ 20,751</u>
Federal income taxes		
Current	\$ 17,274	\$ (33,399)
Deferred		
Current	(7,431)	(7,463)
Non-current	34,067	105,873
Amortization of deferred investment tax credits	(1,812)	(1,605)
	<u>\$ 42,298</u>	<u>\$ 63,406</u>

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A reconciliation of income tax expense from continuing operations at the statutory federal income tax rate to actual income tax expense is as follows:

	2005	2004
Income tax at statutory rate	\$ (90,993)	\$ 14,647
Increases (decreases) resulting from -		
State taxes, net of federal taxes	8,682	14,022
Flow through differences	2,855	1,541
Amortization of deferred investment tax credits	(1,612)	(1,605)
Subsidiary preferred dividends	745	845
Impairment charges	138,720	51,789
Other, net	(2,506)	2,918
Actual income tax expense	\$ 55,671	\$ 84,157

The following table provides the components of the net deferred tax liability from continuing operations at December 31:

	2005	2004
Deferred tax assets:		
Advances and contributions	\$ 72,824	\$ 74,320
Deferred investment tax credits	11,031	11,422
Other postretirement benefits	54,651	58,211
Federal NOL carryforward	82,341	81,801
Pension benefits	72,082	69,621
Long-term debt	45,278	52,248
Capital loss not utilized	7,688	10,013
Other	78,348	83,455
	404,341	419,091
Valuation allowance	(7,688)	(7,686)
	396,655	411,405
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	812,386	761,560
Income taxes recoverable through rates	90,247	91,398
Security costs	9,843	11,525
Business services project expenses	9,344	12,197
Other	38,491	57,847
	958,311	934,327
	\$ (561,656)	\$ (522,922)

At December 31, 2005, the Company has capital loss carryforwards for federal income tax purposes. The Company has determined that these capital loss carryforwards are not more likely than not to be recovered and has recognized a full valuation allowance as of December 31.

The Company believes that its federal net operating loss carryforwards are more likely than not to be recovered and require no valuation allowance.

Note 8 - Debt

The Company's long-term debt (including current portion) amounted to \$4,655,482 and \$4,241,941 at December 31, 2005 and 2004, respectively. Long-term debt includes both secured and unsecured debt generally incurred to fund capital expenditures at the regulated subsidiaries. Secured debt includes general mortgage and tax-exempt bonds of the regulated subsidiaries which are substantially secured by utility plant. Unsecured debt includes debt with RWE amounting to \$2,184,100 and \$2,146,800 at December 31, 2005 and 2004, respectively. Sinking fund payments are required by the terms of certain issues of long-term debt.

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The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	Balance at Dec 31		Sinking Fund Payments and Maturities						Thereafter
	2005	2004	2006	2007	2008	2009	2010		
0% to 1.99%	\$ 269,547	\$ 183,432	\$ 3,865	\$ 3,884	\$ 3,381	\$ 3,401	\$ 3,414	\$ 252,022	
2% to 2.99%	4,833	4,608	133	136	139	141	141	4,143	
3% to 3.99%	239,481	239,388	17	19	20	83,189	(32)	146,288	
4% to 4.99%	1,928,210	1,829,380	1,808,808	804	100,940	584	390	216,808	
5% to 5.99%	880,515	880,888	308	170,308	308	309	308	888,874	
6% to 6.99%	532,477	553,181	14,042	3,016	52,523	22,234	1,888	438,774	
7% to 7.99%	503,886	522,883	4,251	41,731	8,078	2,248	5,238	442,441	
8% to 8.99%	142,789	146,880	3,545	40,247	803	803	7,908	89,485	
9% to 9.99%	148,758	170,870	8,468	8,480	8,468	2,380	10,522	107,419	
10% to 10.99%	25,415	25,802	387	387	387	387	387	23,460	
Capital leases	2,494	1,710	235	221	224	229	232	1,353	
	<u>\$ 4,655,482</u>	<u>\$ 4,241,841</u>	<u>\$ 1,843,855</u>	<u>\$ 288,143</u>	<u>\$ 175,252</u>	<u>\$ 125,673</u>	<u>\$ 30,384</u>	<u>\$ 2,411,165</u>	

Long-term debt includes unamortized fair value adjustments of \$118,923 and \$133,913 at December 31, 2005 and 2004, respectively, from the Acquisitions. Sinking fund payments and maturities include amortization of the Acquisitions fair value adjustments of \$12,820 in 2006, \$13,187 in 2007, \$10,494 in 2008, \$8,333 in 2009, \$7,659 in 2010 and \$66,430 thereafter.

On October 29, 2005, the Company executed a \$550,000 revolving credit agreement with RWE to replace the 364-day \$550,000 revolving credit agreement, which was terminated on October 28, 2005. The renewal date for this new facility was October 28, 2006 and subsequently extended until December 28, 2006. Borrowing under the revolving credit line, at the Company's option, bears interest at a rate based upon the London Interbank Offered Rate ("LIBOR"). The Company pays a commitment fee of 5.45 basis points on the entire amount of the commitment (whether borrowed or not borrowed). The total of the unused lines of credit at December 31, 2005 was \$217,937. No compensating balances are required under the agreement.

At December 31, 2005 and 2004, the Company had \$374,063 and \$859,397 of short-term debt outstanding, respectively. The weighted average interest rate on these borrowings was 3.30% and 2.56%, respectively. On March 1, 2004, the Company refinanced short-term debt with a \$123,000 long-term loan from RWE. The loan was in two tranches of \$113,000 at 4.751% maturing on March 1, 2014 and \$10,000 at 5.801% maturing on March 1, 2034. On September 30, 2004, the Company refinanced short-term debt and maturing notes with a \$75,300 long-term loan from RWE. The loan was in two tranches of \$25,000 at 4.921% maturing on September 30, 2014 and \$50,300 at 5.90% maturing on September 30, 2034.

On March 18, 2005, the Company refinanced short-term loans with a new \$75,000 loan maturing March 18, 2015. The new loan bears interest at the six-month LIBOR plus a margin of 36 basis points reset semi-annually.

On November 12, 2005, long-term loans with RWE of approximately \$445,000 matured. The Company refinanced this debt with \$445,000 in short-term loans from RWE. The majority of the loan balance matured on November 12, 2006 and bore interest at six-month LIBOR plus a margin of 10 basis points. (See Note 18) Additionally a \$42,000 unsecured loan between the Company and RWE due to mature in May 2007 is classified as short-term debt as the loan may be terminated, in full or in part, at any time by either party.

Income from early extinguishment of debts included in interest expense on the Company's Consolidated Statements of Operations amounted to \$11,445 in 2004.

Note 9 - Redeemable Preferred Stock at Redemption Value

Certain preferred stock agreements require annual sinking fund payments in varying amounts and permit redemption at various prices at the option of the subsidiaries on thirty days notice, or in the event of involuntary liquidation, at par value plus accrued dividends.

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The future sinking fund payments and maturities are as follows:

Interest Rate Range	Balance at Dec 31		Sinking Fund Payments and Maturities						
	2005	2004	2006	2007	2008	2009	2010	Thereafter	
3.9% to 4.99%	\$ 1,221	\$ 1,345	\$ 105	\$ 105	\$ 105	\$ 105	\$ 105	\$ 688	
5% to 5.99%	1,750,360	1,750,411	51	51	32	32	32	1,750,182	
6% to 6.99%	457	493	36	36	36	36	36	277	
8% to 8.99%	19,688	20,320	331	161	11	11	11	19,463	
9% to 9.99%	3,198	3,208	10	10	10	10	10	3,148	
	<u>\$ 1,775,224</u>	<u>\$ 1,775,777</u>	<u>\$ 533</u>	<u>\$ 363</u>	<u>\$ 194</u>	<u>\$ 194</u>	<u>\$ 194</u>	<u>\$ 1,773,746</u>	

Thames Water Investments Luxembourg ("TWILUX"), an affiliate and wholly owned subsidiary of RWE, is the holder of \$1,750,000 of the Company's 5.9% preferred stock, par value \$1,000 which was issued in connection with RWE's acquisition of American Water Works Company, Inc. 1,750 shares were authorized and outstanding at December 31, 2005 and 2004. (See Note 14)

Note 10 – Preferred Stock without Mandatory Redemption Requirements

Certain preferred stock agreements do not require annual sinking fund payments and do not permit redemption at the option of the subsidiaries and are as follows:

Dividend Yield	Balance at Dec 31	
	2005	2004
3.9% to 4.99%	\$ 1,720	\$ 1,720
5% to 5.99%	2,851	2,931
	<u>\$ 4,571</u>	<u>\$ 4,651</u>

Note 11: Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities: The carrying amount reported in the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt due to the short-term maturities and variable interest rates, approximates their fair values.

Preferred stock with mandatory redemption requirements and long-term debt: The fair values of preferred stock with mandatory redemption requirements and long-term debt are estimated using discounted cash flow analyses based on current incremental financing rates for similar types of securities.

The carrying amounts and fair values of the financial instruments at December 31 are as follows:

2005	Carrying Amount	Fair Value
Preferred stocks with mandatory redemption requirements	\$ 1,775,224	\$ 1,778,275
Long-term debt (excluding capital lease obligations)	4,652,988	4,563,336
2004	Carrying Amount	Fair Value
Preferred stocks with mandatory redemption requirements	\$ 1,775,777	\$ 1,774,177
Long-term debt (excluding capital lease obligations)	4,240,231	4,119,004

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Note 12: Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were \$20,573 for 2005 and \$23,267 for 2004. The operating leases for facilities will expire over the next 20 years and the operating leases for equipment will expire over the next five years. Certain operating leases have renewal options ranging from one to five years. Capital leases in effect at December 31, 2005 and 2004 are immaterial.

At December 31, 2005, the minimum annual future rental commitment under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are \$19,716 in 2006, \$16,847 in 2007, \$15,202 in 2008, \$13,521 in 2009, \$9,512 in 2010 and \$14,966 thereafter.

Note 13: Related Party Transactions

Thames Water Plc, an affiliate and wholly owned subsidiary of RWE, provided certain management services to the Company which amounted to \$9,147 in 2005 and \$11,480 in 2004.

Thames Water International Services Limited, an affiliate and wholly owned subsidiary of RWE, provided services of expatriate employees to the Company which amounted to \$4,970 in 2005 and \$3,604 in 2004.

Interest on the Company's long-term borrowings with RWE included in interest expense on the Company's Consolidated Statements of Operations amounted to \$88,168 and \$81,129 in 2005 and 2004, respectively.

TWILUX, an affiliate and wholly owned subsidiary of RWE, is the holder of \$1,750,000 of the Company's preferred stock which was issued in connection with the RWE Acquisition. Preferred dividends included in interest expense amounted to \$103,250 and \$103,106 in 2005 and 2004, respectively.

The Company maintains agreements with both public and private water providers for the purchase of water to supplement water supply, particularly during periods of peak demand. The President and CEO of the Company is a Commissioner of one of these water providers. The Company purchased approximately \$16,693 and \$14,525 of water from this provider in the years ended December 31, 2005 and 2004, respectively. The estimated commitments related to minimum quantities of purchased water under these agreements are \$13,862 for 2006. The purchase rates are not set thereafter.

Note 14: Commitments and Contingencies

Commitments have been made in connection with certain construction programs. In connection with obtaining the regulatory approvals necessary to complete RWE's acquisition of American Water Works Company, Inc., certain state regulatory bodies have issued orders which prohibit certain of the Company's regulated subsidiaries from requesting rate increases for periods of time not exceeding three years.

The Company is routinely involved in condemnation proceedings and legal actions relating to several subsidiaries. In the opinion of management, none of these matters is expected to have a material adverse effect, if any, on the financial position, results of operations or cash flows of the Company.

The Company's regulated subsidiaries maintain agreements with other water purveyors for the purchase of water to supplement their water supply. The Company's subsidiaries purchased water expense under these types of agreements amounted to approximately \$92,395 and \$82,948 during the years ended December 31, 2005 and 2004, respectively.

The estimated annual commitment related to the minimum quantities of water purchased is expected to approximate \$38,700 in 2006, \$39,191 in 2007, \$38,992 in 2008, \$38,923 in 2009, \$39,317 in 2010 and \$555,296 thereafter.

Notice of termination of the \$1,750,000 of preferred stock with TWILUX, long-term debt of approximately \$2,184,120 with RWE, and short-term debt of approximately \$374,063 with RWE in part or in full on demand at the option of RWE is possible and mandatory if there is a change in shareholder structure of the Company.

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Note 15: Guarantees

A subsidiary holds a 50% interest in AW-Pridesa, a Delaware limited liability company. Pridesa America Corporation, a former subsidiary of RWE and an affiliate of the Company, also holds a 50% interest. AW-Pridesa has contracted with Tampa Bay Water ("Tampa Bay"), an interlocal governmental agency of the State of Florida, to remedy and operate the Tampa Bay Seawater Desalination Plant. The Company entered into a guarantee with Tampa Bay on November 15, 2004 for the full and prompt performance of certain contractual obligations limited to a total aggregate liability of \$35,000. Contractual obligations call for certain construction activities and management services to be completed satisfactorily. The construction phase, amounting to approximately \$30,000 is expected to be completed in 2006. AW-Pridesa took over operation of the plant on January 8, 2005.

OMI/Thames Water Stockton, Inc. ("OMI/TW") is a 50/50 joint venture between a subsidiary and Operations Management International, Inc. ("OMI"). In February 2003 OMI/TW and the City of Stockton California entered into a 20 year Service Contract for water, wastewater and storm water utilities capital improvements and management services. Capital improvements totaling \$58,000 were included in the contract and an affiliate of the Company has currently provided a guarantee. The Company is expected to assume the required parental guarantee of OMI/TW's obligations, including full performance and payment. (See Note 18).

Note 16: Goodwill and Intangible Assets

As of December 31, 2005 and 2004, the Company reviewed goodwill associated with its reporting units for impairment, and, as part of its assessment, the Company engaged an independent valuation firm. The performance of the impairment test involves a two-step process. The first step of the impairment test involves comparing the fair value of a reporting unit with the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, a second step is performed to determine the amount of the impairment loss. The impairment loss is determined by comparing the implied fair value of goodwill with the carrying amount of goodwill. The Company believes that the estimates of fair value are reasonable. Changes in estimates of such fair value, however, could affect the calculation. The valuation was performed primarily using discounted cash flows and comparable public company analyses. As of December 2005 and 2004, the Company recorded an impairment charge for goodwill, including discontinued operations, related to certain reporting units in the amount of \$396,348 and \$192,936, respectively. The 2004 impairment charge for the unregulated business is primarily attributable to lower than expected growth and slower development compared with original expectations. The 2005 charge is primarily attributable to a change in the Company's strategic business plan for the unregulated business and lower margins than previously forecasted in the regulated business.

The change in the Company's goodwill assets, as allocated between the reporting units in 2005 and 2004, was as follows:

Reporting Unit	Balance as of December 31, 2003	Goodwill reclassified to assets of discontinued operations	2004 Impairment Losses	Balance as of December 31, 2004	2005 Impairment Losses	Balance as of December 31, 2005
Regulated	\$ 3,345,051	\$ -	\$ -	\$ 3,345,051	\$ (341,946)	\$ 3,003,105
Operations & maintenance	40,075	-	(40,075)	-	-	-
Residuals	89,841	-	(56,163)	34,678	(20,181)	14,497
Underground	87,777	-	(51,836)	18,141	(10,773)	5,368
Carbon	4,233	-	(1,095)	3,138	(1,388)	1,752
Engineering	82,235	(18,218)	(44,967)	1,052	-	1,052
Homeowner services	121,800	-	-	121,800	-	121,800
Military	28,190	-	-	28,190	(22,060)	6,130
Total	\$ 3,758,202	\$ (18,218)	\$ (192,936)	\$ 3,550,050	\$ (366,348)	\$ 3,153,702

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Other intangible assets consist of customer contracts which were initially valued and recorded as part of the Acquisitions. The aforementioned operating conditions which caused the goodwill impairment charge also triggered the intangible asset impairment. The amount of impairment recorded by the Company in 2005 and 2004 was determined using the two-step process impairment review required by Statement of Financial Accounting Standards No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." In the first step, the projected undiscounted net cash flows associated with the Company's customer contracts over its remaining life were compared to their carrying amounts. The Company determined the carrying amount of its customer contracts exceeded its projected undiscounted cash flows. In the second step, the Company estimated the fair value of the Company's customer contracts using a variation of the income method of valuation for the Operations & Maintenance reporting unit, and estimated discounted cash flows for the Residuals reporting unit. Based on the Company's valuation, the Company recorded a non-cash impairment charge of \$733 and \$11,277 for the years ended December 31, 2005 and 2004, respectively, which was recorded in impairment charges in the Company's statements of operations. The Company has no intangible assets as of December 31, 2005. Amortization expense for intangible assets subject to amortization prior to the intangible impairment for the years ended December 31, 2005 and 2004 was \$67 and \$1,579, respectively.

Note 17: Discontinued Operations

After an evaluation of the unregulated businesses, it was determined that the Company's Ashbrook, Leopold and Engineering businesses were not meeting growth expectations and were not considered core businesses of the Company's operations. Accordingly, the Company sold and/or disposed of these businesses. As a result of these dispositions, the Company recorded net losses in 2005 and 2004 of \$16,350 and \$0, respectively.

During the fourth quarter of 2005, the Company sold Engineering's Canadian operations, a provider of engineering services to corporate and municipal clients, for initial consideration of \$489 and contingent consideration of \$430. Furthermore, the Company disposed through abandonment Engineering's operations based in the United States. As a result of the disposition of Engineering in 2005, the Company recorded a loss of \$16,350 which included a goodwill write-off \$16,216.

During the first quarter of 2005, Ashbrook, a provider of wastewater treatment services, closed on the sale of substantially all its assets for \$14,847. Based on the Company's assessment of Ashbrook's estimated fair value, an impairment charge of \$5,902 was recorded in the fourth quarter of 2004.

During the first quarter of 2004, the Company closed on the sale of Leopold, a supplier of products and services to water and wastewater treatments, for \$17,000.

A summary of the assets and liabilities classified as discontinued operations in the Consolidated Balance Sheets includes the following:

	2005	2004
Assets of discontinued operations		
Non-utility property	\$ -	\$ 1,752
Cash	-	9
Other receivables, net	238	24,782
Other current assets	2,520	7,338
Goodwill	-	16,216
Total assets of discontinued operations	2,758	50,107
Liabilities of discontinued operations		
Accounts payable	-	3,182
Other liabilities	-	17,374
Total liabilities of discontinued operations	-	20,556
Net assets of discontinued operations	\$ 2,758	\$ 29,551

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A summary of discontinued operations presented in the Consolidated Statements of Operations include the following:

	2005	2004
Operating revenues	\$ 14,020	\$ 71,504
Operating expenses		
Operation and maintenance	15,896	67,170
Depreciation and amortization	-	582
Impairment charges	-	50,889
Total operating expenses, net	15,896	118,601
Operating loss	(1,876)	(47,097)
Other income (deductions)		
Other, net	582	(189)
Total other income (deductions)	582	(189)
Loss before income taxes	(1,294)	(47,286)
Provision for income taxes	(949)	(1,297)
Loss from operations	(345)	(45,989)
Loss on sale, net of \$69 tax benefit	(16,350)	-
Loss from discontinued operations	\$ (16,895)	\$ (45,989)

Note 18: Subsequent Events

RWE Divestiture

RWE has announced its intention to divest the Company through an Initial public offering ("IPO"). The sales process has been initiated through filing for approval with certain state public utility commissions. The IPO will require filing of a registration statement with the U.S. Securities and Exchange Commission. The transaction will also be subject to approval of the RWE Supervisory Board. RWE expects to complete the IPO during 2007.

Financing Activities

In August 2006, the Company borrowed \$487,000 from RWE at LIBOR plus 10 basis points maturing in August 2007. Proceeds of the debt issue were used to pre-pay RWE debt and reduce borrowings under the RWE credit facility.

In October 2006, the Company refinanced \$25,770 of high interest rate tax-exempt bonds with new 4.88% tax-exempt bonds maturing in October 2036.

In December 2006, RWE made a \$1,194,454 equity contribution to the Company. The Company used this contribution to offset loans payable to RWE.

In December 2006, the Company refinanced \$57,480 of high interest tax-exempt bonds maturing December 2036 with 4.6% tax-exempt bonds maturing in December 2036.

In December of 2006, the Company finalized an agreement to sell \$900,000 of senior secured notes offered through a private placement with maturities ranging from 7 to 15 years at fixed interest rates of 5.39% to 5.77% and elected to close the sales on three separate dates. The first closing, in the amount of \$483,000, occurred on December 21, 2006. The two subsequent closings are expected to occur in January and February 2007 for the balance of the \$900,000, subject to fulfillment of customary closing conditions. Proceeds will be utilized to refinance a large portion of the Company's debt with RWE and reduce short-term borrowings.

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Dispositions

The Company had committed to a plan of disposal for its unregulated Residuals in 2005. In 2006, the Company sold certain assets of Residuals for \$3,000 and in December 2006, the Company signed a letter of intent for another component of the business for \$10,000. The remaining business is expected to be sold in 2007.

In November 2006, the Company's unregulated Underground business was sold for \$28,600, subject to a minimum tangible net worth adjustment.

The net gain (loss) on these disposals is not expected to be material.

Contingencies

In November 2006, a California County Superior Court held that the City of Stockton California had not complied with the requirements of the California Environmental Quality Act when it entered its agreement with OMI/TW. The California court has entered a writ requiring the city to rescind the contract within 180 days. The City of Stockton has not yet determined if it will appeal this decision. The amount of the loss, if any, OMI/TW may sustain if it is unable to recover its investment in the project is not presently determinable. The Company's portion of revenue since inception of the contract in August of 2003 is approximately \$60,000.

Rate Matters

Throughout 2006, regulatory commissions authorized fourteen subsidiaries to increase rates for service by an annual amount of \$25,582.